SIA

Foreign Activity

An Analysis of Foreign Participation in the U.S. Securities Markets
Produced by the SIA Research Department

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Foreign Activity In U.S. Equities: They're Back?

Despite a steady increase in interest rates during the first quarter of 1989, foreign investors took their cue from unexpected strength in the dollar. Displaying cautious confidence in the U.S. equity market, foreign investors made net purchases in 1Q89 totalling $389 million. In stark contrast, foreign investors sold near $2.8 billion of U.S. equities in the 4Q88.

The change in net activity came on a 21.5% increase in gross activity, from $75.7 billion to $91.8 billion. The first quarter total compares favorably to last year's quarterly average of $91 billion but, still suffering from the aftermath of October 1987, was off nearly 25% from 1987's quarterly average of $120.4 billion.

GROSS TRANSACTIONS IN AND NET PURCHASES OF U.S. EQUITIES
($MILLIONS)

	FOURTH QUARTER 1988		FIRST QUARTER 1989		
	GROSS ACTIVITY	NET PURCHASES	GROSS ACTIVITY	NET PURCHASES	% CHANGE 1Q89 4Q88
EUROPE	**$39,438**	**($1,800)**	**$47,224**	**($154)**	**22.9%**
BELGIUM-LUXEMBOURG	1,946	(79)	2,920	(12)	50.1%
FRANCE	3,058	(24)	3,365	268	10.0%
GERMANY	2,758	35	4,082	148	48.0%
NETHERLANDS	1,211	(14)	1,753	69	44.8%
SWITZERLAND	8,863	(758)	10,410	(1,434)	17.2%
UNITED KINGDOM	17,779	(1,044)	22,219	767	25.0%
CANADA	**9,464**	**733**	**10,331**	**1,089**	**9.3%**
LATIN AMERICA & CARIBBEAN	**10,377**	**450**	**12,220**	**1,806**	**17.8%**
BERMUDA	1,658	(12)	2,311	485	39.4%
NETHERLANDS ANTILLES	3,738	199	4,247	999	13.6%
ASIA	**15,533**	**1,949**	**20,214**	**(1,299)**	**30.1%**
HONG KONG	1,483	(51)	2,174	56	46.6%
JAPAN	9,860	(900)	12,826	(1,508)	30.1%
OIL EXPORTING COUNTRIES	3,497	(827)	4,233	385	21.0%
TOTAL ALL COUNTRIES*	**$75,609**	**($2,751)**	**$91,836**	**$389**	**21.5%**

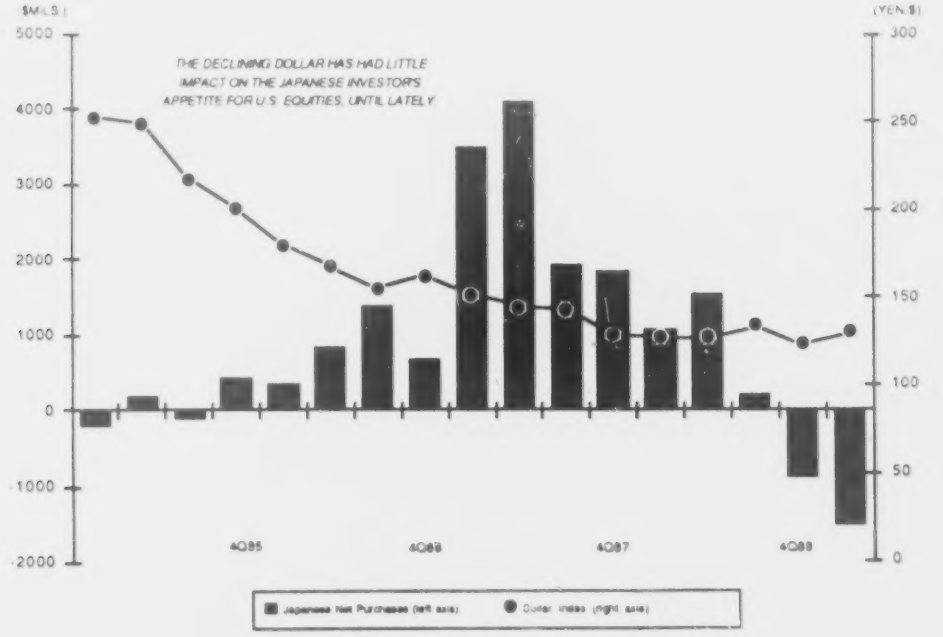
Source: U.S. Treasury

The appetite for U.S. equities during 1Q89 was not broad-based. Indeed, while gross transactions increased for all countries, both European and Asian investors were net sellers of U.S. equities. Specifically, Swiss and Japanese investors were net sellers for a combined total of $3 billion. For Swiss investors, net sales of $1.4 billion in the first quarter continued a string of divestment which has lasted six consecutive quarters.

Though the dollar rebounded in the first quarter, Japanese investors continued to display concern over the direction of the dollar. Japanese investors, who made net sales of $900 million in the 4Q88, reduced their holdings by an additional $1.5 billion in the 1Q89. However, preliminary data from the Bank of Japan indicate a resurgence in Japanese accumulation of overseas equities; net purchases of overseas equities in April totalled $1.7 billion alone.

The chart below graphs the relationship between the declining dollar and net purchases of U.S. equities by Japanese investors. The graph indicates that while the psychological impact of the decline in the dollar does seem to have had a negative impact on these investors' appetite for U.S. equities, the impact has been recent. Indeed, the decline in the dollar seems, for the most part, to have had little impact until recently. One explanation may lie with the increased purchasing power of the Yen which, when combined with deregulation in Japan and growing capital surpluses, outweighed any effect the decline in the dollar had on Japanese interest in U.S. equities.

JAPANESE NET PURCHASES OF U.S. EQUITIES



In terms of gross activity, Japanese investors have slumped to pre-1987 levels. While first quarter activity of $12.8 billion rebounded 30.1% over the previous quarter's $9.9 billion, it is still 51% below 1988's quarterly average of $26.2 billion and 50% below 1987's $25.6 billion.

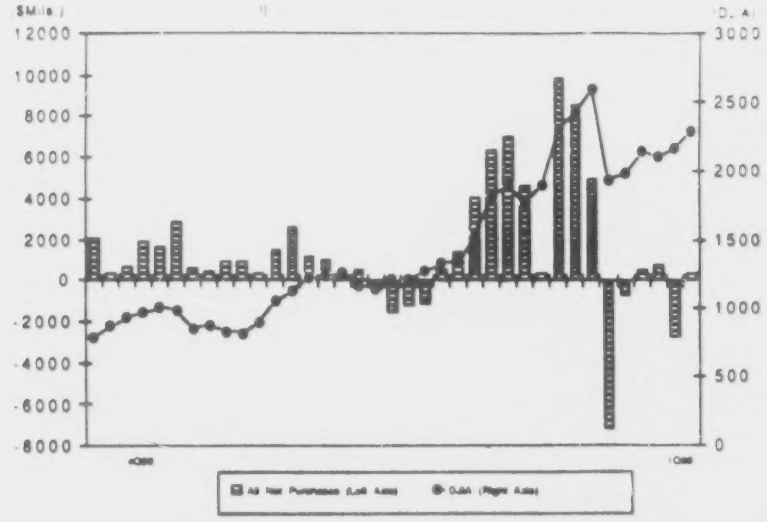
On the other hand, those foreign investors who committed capital to the U.S. equity markets were not only treated to a 6% increase in equity prices (as measured by the DJIA) but an increase in the value of the dollar.

Canadian investors, who increased their gross activity in U.S. stocks by 9.3% to $10.3 billion, were the largest net purchasers of U.S. stocks, over $1 billion. Further, the $1 billion plus in capital committed to the U.S. equity market in the first quarter exceeded total net purchases made by Canadian investors in any other previous quarter or year.

U.K. investors, after making over $1 billion in net sales of U.S. equities during the 4Q88, reversed gears and made $767 million in net purchases. With U.K. equity prices increasing 14% in January, and 15.7% for the quarter, their interest in U.S. equities was focused in February, with $800 million in net purchases. The prospect of further tightening of U.K. monetary policy and the subsequent adverse impact on equity prices contributed to U.K. investors seeking other markets.

Finally, the chart below graphs quarterly net purchases of U.S. equities by foreign investors versus quarterly movements in the Dow. While a rigorous statistical analysis would give us some clue as to correlation and causation in these movements, the graph indicates that lately, foreign investors (as a group) have done their most active net purchasing prior to a downturn, or levelling off, of the Dow. However, that the sharpest increases in the Dow (1986 and 1987) should be accompanied by large net purchases by foreign investors may support those who argue that foreign purchases are crucial to stock price trends.

Foreign Net Purchases Of U.S. Equities
And Movements In The Dow



Foreign Activity In U.S. Treasuries: Support For The Dollar

With higher interest rates underpinning the stronger U.S. dollar, net purchases of U.S. Treasuries by foreign investors exceeded $20 billion in the

first quarter, well over the fourth quarter's $11 billion. Trading volume was also strong as gross transactions increased 21.5% over the fourth quarter's $710 billion, to $863 billion. We estimate that foreign turnover in U.S. Treasuries is about 14.5% of the volume reported by U.S. primary dealers.

GROSS TRANSACTIONS IN AND NET PURCHASES OF
U.S. TREASURY NOTES AND BONDS
($MILLIONS)

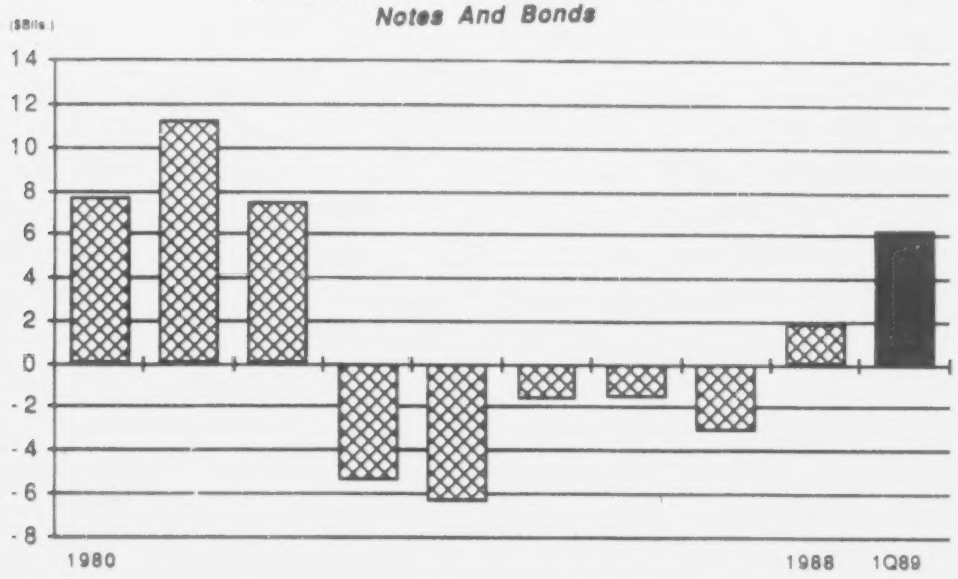
	FOURTH QUARTER 1988		FIRST QUARTER 1989		
	GROSS ACTIVITY	NET PURCHASES	GROSS ACTIVITY	NET PURCHASES	% CHANGE 1Q89-4Q88
EUROPE	$278,512	$1,848	$368,946	$8,294	32.5%
GERMANY	6,666	(1,144)	11,709	711	75.7%
SWITZERLAND	4,411	(341)	6,328	2,484	43.5%
UNITED KINGDOM	194,081	695	243,736	2,631	25.6%
ASIA	336,936	7,774	423,323	12,205	25.6%
JAPAN	286,207	4,287	356,737	4,467	24.6%
"OTHER ASIA"	23,335	2,177	$26,073	$6,280	11.7%
NONMONETARY INT'L & REGIONAL ORGANIZATIONS	$47,298	780	$28,439	$7	(39.9%)
TOTAL ALL COUNTRIES	$710,218	$11,112	$862,780	$20,412	21.5%

Source U.S. Treasury

Support for the dollar was evident in the first quarter as central banks made net purchases of $12.8 billion, over two and a half times the 4Q88's $5 billion. Moreover, while this represents the second highest level ever, it is still well below the record $20.4 billion in the 1Q88.

The appetite of private investors for U.S. Treasuries reached new heights as a record $7.6 billion in net purchases were made. However, similar to the narrow interest in U.S. equities, private purchases of U.S. Treasuries were almost exclusively made by OPEC. Indeed, OPEC made record net purchases of $6.3 billion in the first quarter, nearly double their previous high of $3.2 billion made in the 3Q86. Marking the third consecutive quarter in which OPEC has added to their holdings of U.S. Treasuries, the graph indicates that their return to the U.S. market has occurred as suddenly and sharply as did their disappearance.

OPEC Net Purchases Of U.S. Treasury Notes And Bonds



Over $4.4 billion in net purchases were also made by Japanese investors. In light of OPEC's considerable purchases, and strong support by central banks for the dollar, we believe that most of the Japanese net purchases were made by the Bank of Japan. Moreover, the table below indicates the movement away from dollar bonds by Japanese life insurance companies, the dominant investor group in Japan.

"Big Five" Life Insurance Companies
Foreign Bond Portfolios Weighting By Currency

	U.S. $		*Pounds*		*Aus. Dollars*	
Company	*Dec. 88*	*Sept. 87*	*Dec. 88*	*Sept. 87*	*Dec. 88*	*Sept. 87*
Nippon	52%	59%	12%	3%	11%	6%
Daiichi	40	38	8	9	17	7
Sumitomo	42	48	15	4	2	3
Meiji	32	32	13	9	15	14
Asahi	32	44	10	8	4	6

Source: Salomon Brothers Inc

Similarly, Swiss and U.K. inflows of $2.5 billion and $2.6 billion, respectively, are also believed to substantially represent official purchases.

U.S. Activity In Foreign Equities

U.S. investors stepped up their activity in foreign equity markets in the first quarter, with the main attraction being the Japanese equity market.

Gross transactions in foreign equities totalled $50.5 billion, up 15.8% from the fourth quarter's $43.6 billion. Net purchases nearly reached $1.7 billion, almost equalling 1988's full year total of $1.85 billion.

GROSS TRANSACTIONS IN AND NET PURCHASES OF FOREIGN STOCKS BY U.S. INVESTORS
($MILLIONS)

	FOURTH QUARTER 1988		FIRST QUARTER 1989		
	GROSS ACTIVITY	NET PURCHASES	GROSS ACTIVITY	NET PURCHASES	% CHANGE 1Q89-4Q88
EUROPE	$22,637	$175	$24,816	$1,152	9.6%
FRANCE	1,384	92	1,393	147	0.7%
GERMANY	1,056	120	1,428	(26)	35.2%
NETHERLANDS	1,188	(296)	1,091	123	(8.2%)
SWITZERLAND	1,764	(106)	1,535	161	(13.0%)
UNITED KINGDOM	15,628	430	17,654	586	13.0%
CANADA	2,150	(260)	2,226	108	3.5%
ASIA	15,878	1,578	20,107	867	26.6%
JAPAN	14,196	1,242	18,168	730	28.0%
OTHER	2,910	(136)	3,319	265	14.1%
TOTAL ALL COUNTRIES	$43,575	$1,357	$50,468	$1,662	15.8%

Source: U.S. Treasury

In an attempt to make up for lost time, U.S. investors committed $730 million to the Japanese market in the first quarter, boosting their Japanese equity assets by nearly $2 billion in the last two quarters. However, those investors looking for short-term gains were disappointed. The strength in the U.S. dollar relative to the Yen led to a currency adjusted return of (1.4%); considerably less than the eye-popping 35.4% gain last year.

EQUITY MARKET
RETURNS FOR U.S. INVESTORS
(U.S. DOLLARS)

	% CHANGE DEC. 1988-MARCH
EUROPE	2.4
FRANCE	0.3
GERMANY	(5.9)
NETHERLANDS	3.5
SWITZERLAND	(5.1)
UNITED KINGDOM	8.0
CANADA	7.0
ASIA	(1.2)
JAPAN	(1.4)
WORLD ex. U.S.	0.2
U.S.	6.1

Source: Goldman Sachs FT-Actuaries World Indices

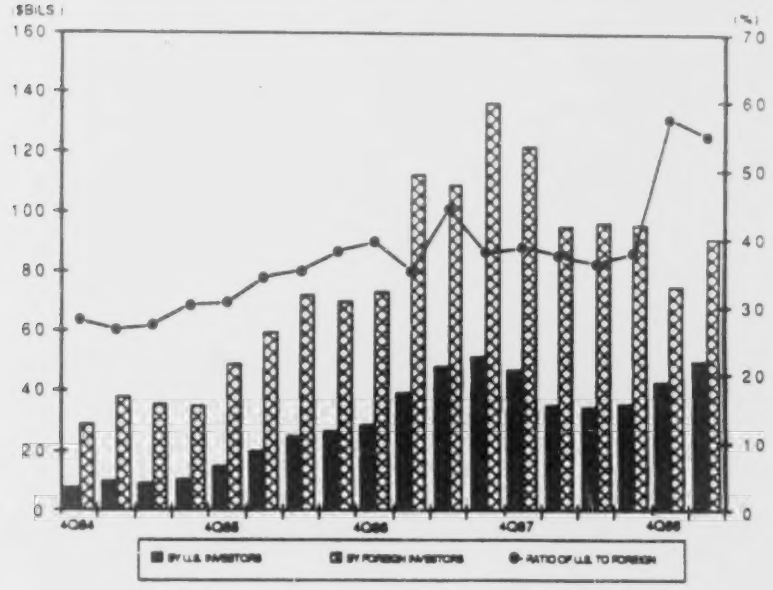
With European stocks showing a modest 2.4% gain for the quarter, U.S. investors made net purchases of $1.2 billion. U.K. stocks, of which U.S. investors made net additions of $586 million, were the equities of choice.

Not surprisingly, U.S. investors were net sellers of $26 million worth of German equities. After a rise of over 30% in 1988, German equities began to show weakness in the 1Q89. The strengthening dollar may have given U.S. investors an additional reason for ignoring German equities.

During the first quarter, U.S. investors made transactions in foreign equities of $50.5 billion, nearly 16% over the fourth quarter's $43.6 billion. The first quarter total nearly eclipsed the record $51.8 billion traded in the third quarter of 1987. To further put the first quarter total in perspective, it is interesting to note that as recently as 1985, gross activity in foreign shares by U.S. investors only totalled $45.1 billion for the year.

Further, the chart below shows that since the crash, U.S. gross activity in foreign equities has steadily regained momentum, and is now trading at 1987 levels. On the other hand, foreign activity in U.S. stocks, is still well below the levels recorded in 1987. This has led to a situation where U.S. investors' transactions in foreign stocks totalled over 50% of that traded by foreign investors in U.S. equities for the two most recent quarters, well above previous levels.

Relative To Foreign Investors,
U.S. Investors Are Increasingly Active Overseas

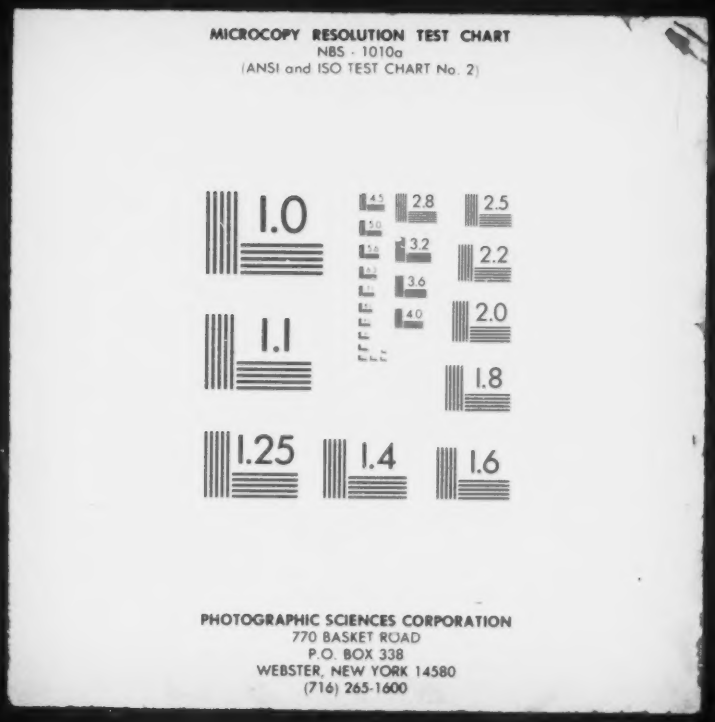


David G. Strongin
Director,
International Finance

GROSS TRANSACTIONS IN AND NET PURCHASES OF U.S. CORPORATE BONDS
($MILLIONS)

	FOURTH QUARTER 1988		FIRST QUARTER 1989		
	GROSS ACTIVITY	NET PURCHASES	GROSS ACTIVITY	NET PURCHASES	% CHANGE 1Q89-4Q88
EUROPE	**$14,318**	**$5,370**	**$13,982**	**$4,080**	**(2.3%)**
BELGIUM-LUXEMBOURG	445	(77)	585	(111)	31.5%
FRANCE	574	(68)	457	143	(20.4%)
GERMANY	960	124	757	217	(21.1%)
SWITZERLAND	865	349	820	262	(5.2%)
UNITED KINGDOM	9,820	4,432	10,372	3,390	5.6%
ASIA	**6,622**	**1,398**	**6,703**	**323**	**1.2%**
JAPAN	5,697	1,279	5,226	(142)	(8.3%)
"OTHER ASIA"	515	65	988	220	91.8%
TOTAL ALL COUNTRIES	**$23,820**	**$7,242**	**$23,948**	**$5,594**	**0.5%**

Source: U.S. Treasury



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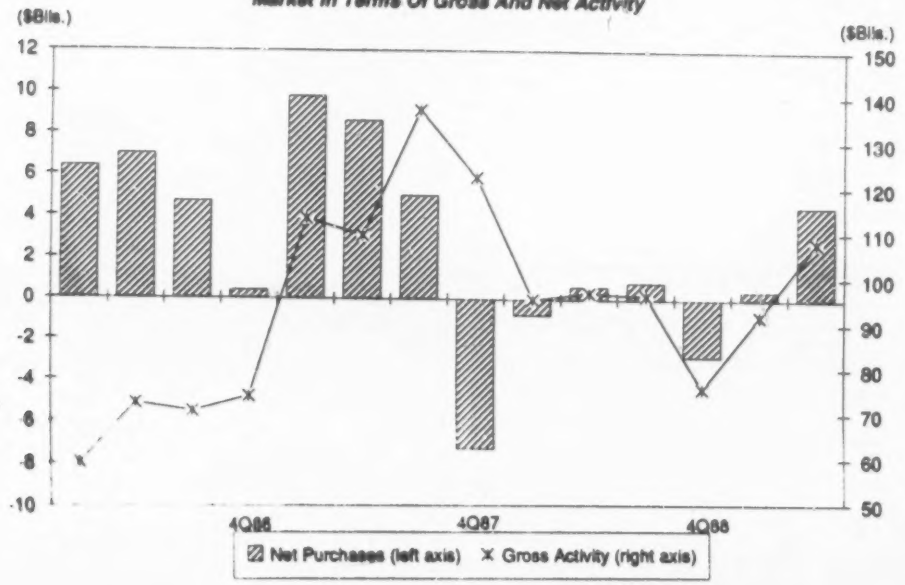
Foreign Investment: A Two Way Street

Foreign Investors Show Renewed Vigor....

It's almost like they never left. Foreign investors, after months of nibbling at U.S. equities, finally took a full bite in the second quarter, making net purchases of near $4.5 billion. Nearly $3.6 billion were made in June alone, a month which saw social upheaval in China, a cut in the U.S. prime rate, a monthly year-to-date high in NYSE share volume, and frenzied takeover activity. (Including offers by Paramount for Time, McCaw Cellular for LIN Broadcasting, and Wasserstein, Perella and A&P for the U.K.'s Gateway.)

Foreign Investors Return To The U.S. Equity Market In Terms Of Gross And Net Activity



The sharp increase in net activity was accompanied by renewed strength in gross activity. Foreign investors bought and sold over $107 billion in U.S. equities in the second quarter, marking the first time in over a year that quarterly activity topped the $100 billion mark.

The U.K., Japan and OPEC accounted for slightly over 100% of net purchases and 43% of gross activity, by all countries.

Country of Investor	*2Q89 Net Purchases of U.S. Equities ($Mils.)*
Japan	$1,869
OPEC	1,539
U.K.	1,112
All others	(20)
Total	**$4,500**

Confidence in the U.S. economy and a relatively stable dollar, coupled with increasing U.S. equity prices, may signal continued interest in future months. Indeed, we suspect that these purchases were critical in increasing U.S. equity prices during the second quarter. But, recent moves by the G-7 to weaken the dollar may dampen the enthusiasm of foreign investors for U.S. equities, thereby weakening prices, which is consistent with recent trends in September.

While U.S. Investors Continue Their Return....

In the four-month period beginning October 1987, U.S. investors were net sellers of nearly $4.2 billion in foreign equities. This massive repatriation of funds, which exceeded any year's commitment to overseas equity markets, convinced many observers that U.S. investors' return to overseas markets would be a long time coming.

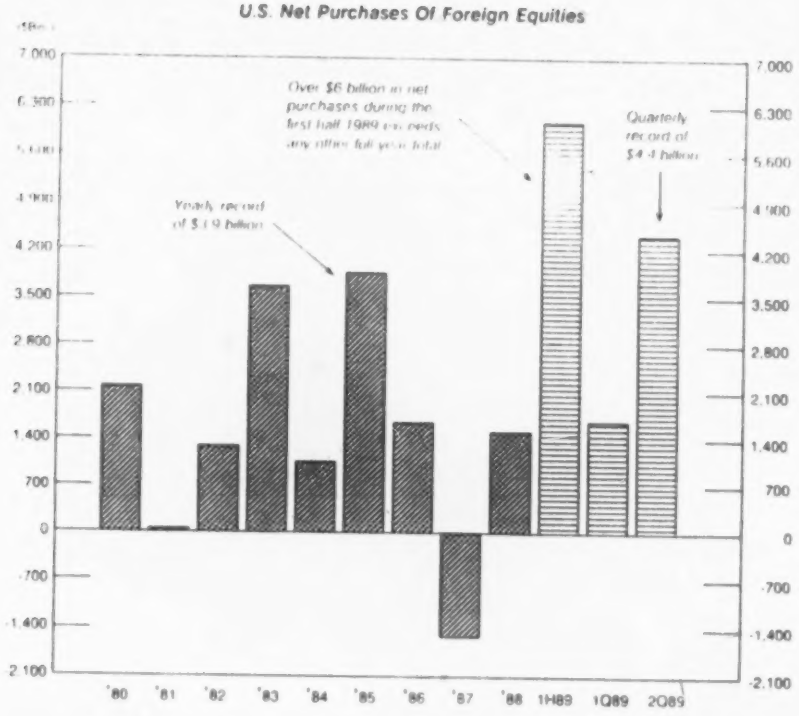
Yet, U.S. investors have subsequently returned to overseas equity markets with such force that even the biggest optimist must be shocked. Since February 1988, U.S. investors have made net purchases of over $8.2 billion in foreign equities. Indeed, U.S. investors have not missed a beat, making net purchases in 13 consecutive months (June 1988-June 1989) totalling $8.1 billion.

And Set New Records During the 1H 1989

Net purchases of foreign equities totalled nearly $6.1 billion during the 1H89, with the record $4.4 billion made in the second quarter alone exceeding any previous full year total. Looked at slightly differently, U.S. investors have averaged net purchases of over $1 billion per month in 1989; in contrast, the record for any previous full year was $3.9 billion (or an average of $325 million per month).

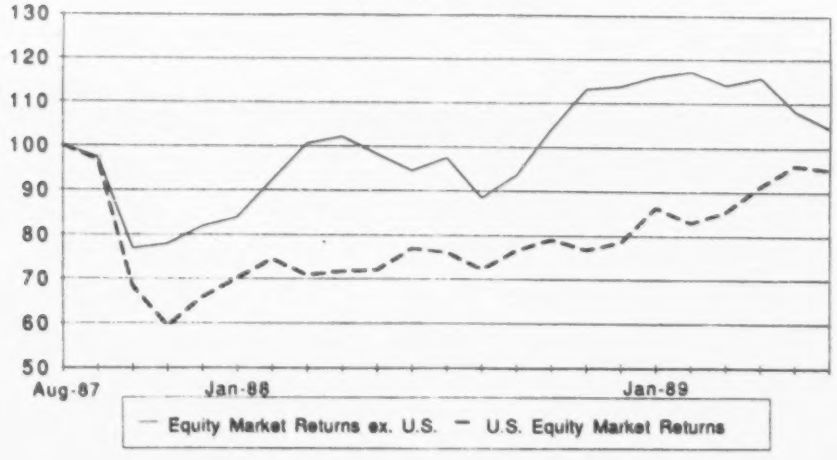
The U.S. return to foreign equity markets may have been an epiphany of sorts; a realization that foreign equity markets, as a whole, shook off the effects of the crash much more quickly than the U.S. equity market. For example, foreign markets rose to pre-crash levels (in dollar terms) in merely five months. In contrast, during this period U.S. equities recovered only 2.5%. So, after missing the first big move overseas, U.S. investors have taken part in the latest surge. And a good thing: by the end of June 1989, overseas equity markets had out-performed the U.S. market. However, the graph below indicates that while U.S. equity returns continue to lag those of foreign markets, the gap is steadily closing.

U.S. Net Purchases Of Foreign Equities



While the recent surge in U.S. equity prices will no doubt draw funds which would have been earmarked for foreign equities, we believe the outlook for continued overseas investment is a positive one. The path toward Europe 1992 may lead U.S. investors to up their European equity commitment in hopes of finding the winners. Moreover, the increased sophistication of investors with respect to futures and options may also lessen any risk of currency losses, removing a significant barrier to overseas investment.

Overseas Equity Market Returns vs. U.S.
(August 1987 = 100)



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